No. 87-769

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

JOHN OLAGUES,

Petitioner.

versus

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

RICHARD JAMES FRENCH, d/b/a NEILD CRUIKSHANK & COMPANY—PACIFIC; JOSE PASCUAL; HARRY C. POLONITZA AND COMPANY; STEVEN S. MITCHELL and ALAN SCHMIDT,

Respondent.

versus

DAVID CHAN; OPEX INVESTMENTS INC.; RUDOLF M. BINNEWIES; WILLIAM A. CHARLES; SOLD INC., MONTGOMERY AND MADER, N.A., MONTGOMERY; RICHARD E. MADER and CRAIG A. RESNICK,

Respondent.

versus

Certain Unknown Purchasers of the Common Stock of and Call Options for the Common Stock of Santa Fe International Corporation; CREDIT SUISSE; SWISS AMERICAN SECURITIES, INC., CITIBANK, N.A.; LOMBARD ODIER & CRI.; MORGAN GUARANTY TRUST COMPANY OF NEW YORK; SWISS BANK CORPORATION; DREXEL BURNHAM LAMBERT, INC.; THE CHASE MANHATTAN BANK, N.A.; MOSELEY, HALLGARTEN, ESTABROOK & WEEDEN, INC.; FAISAL AL MASSOUD AL FUHAID,

Respondent.

BRIEF OF THE FRENCH RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

HERBERT E. MILSTEIN*
STEVEN J. TOLL
PATRICIA F. BAK
COHEN, MILSTEIN & HAUSFELD
1401 New York Ave., N.W.
Suite 600
Washington, D.C. 20005
(202) 628-3500
Counsel for the French Respondents

*Counsel of Record

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

TABLE OF CONTENTS

		Page
I.	Statement	2
II.	The District Court and Court of Appeals Correctly Disposed of Petitioner's Claims	6
III.	The Petition Fails to State a Reason for Granting *Certiorari*	11
IV.	Conclusion	12

TABLE OF AUTHORITIES

CASES	Page
Charles, et al. v. Keaton, et al., Civil Action No. C-84-6320 (WHO) (N.D. Cal.)	2
French, et al. v. al Fuhaid, et al., 83 Civ. 1745 (RLC) (S.D.N.Y.)	2
French, et al. v. Keaton, et al., 84 Civ. 6811 (RLC) (S.D.N.Y.)	2
In re Mid-Atlantic Toyota Antitrust Litigation, 564 F. Supp. 1379 (D. Md. 1983)	8
Marshall v. Holiday Magic, Inc., 550 F.2d 1173 (9th Cir. 1977)	8
SEC v. Andes, No. 82-1659, *slip op.* at p. 4 (E.D. Pa. Jan. 23, 1986)	10
SEC v. Blatt, 583 F.2d 1325 (5th Cir. 1978)	9
SEC v. Blavin, 7660 F.2d 706 (6th Cir. 1985)	10
SEC v. Canadian Javelin, Ltd., 64 F.R.D. 648 (S.D.N.Y. 1974), *appeal dismissed*, 538 F.2d 313 (2d Cir. 1976)	9
SEC v. Cert. Unknown Purchasers of Common Stock, 817 F.2d 1018 (2d Cir. 1987)	3,4
SEC v. Commonwealth Chemicals Securities, Inc., 574 F.2d 90 (2d Cir. 1978)	9
SEC v. Everest Management Corp., 475 F.2d 1236 (2d Cir. 1972)	9
SEC v. Penn Central Co., 425 F. Supp. 593 (E.D. Pa. 1976)	9
SEC v. Randolph, 736 F.2d 525 (9th Cir. 1984)	7,8
SEC v. Vesco, 58 F.R.D. 182 (S.D.N.Y. 1973)	9
U.S. v. City of Miami, 614 F.2d 1322, n.18 (5th Cir. 1980), *aff'd as modified*, 664 F.2d 435 (5th Cir. 1981)	8
STATUTES, RULES AND REGULATIONS	
Fed. R. Civ. P. 24	9
Fed. R. Civ. P. 24(a)	5
RICO, 18 U.S.C. §1961	3
Rule 17 of the Supreme Court Rules	11

Table of Authorities Continued

	Page
SEC Rule 10b-5, 17 C.F.R. §2240.10b-5	2,5,10
Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. §78j(b)	2
MISCELLANEOUS	
2 *Newberg on Class Actions,* Section 8.04 (2d ed. 1986)	8

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I. Statement

On October 26, 1981 the Securities and Exchange Commission ("SEC" or the "Commission") filed an enforcement action alleging that from September 21 through October 1, 1981, the defendant "unknown purchasers" and Faisal al Massoud al Fuhaid violated § 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10b-5 by purchasing call options and shares of the common stock of Santa Fe Int'l Corporation based on insider information. The Commission sought injunctions against future violations as well as disgorgement of illegal profits received as a result of defendants' unlawful trading. On October 26, 1981, the district court entered a temporary restraining order freezing all profits which could be subject to the SEC's sought disgorgement.

During the pendency of the SEC's enforcement action two groups of private investors the French and Charles respondents,[1] brought civil suits against

[1] The French and Charles respondents refer to two groups of options traders who commenced private actions against the defendants in the SEC enforcement action. *French, et al. v. Keaton, et al.*, 84 Civ. 6811 (RLC) (S.D.N.Y.); *French, et al. v. al Fuhaid, et al.*, 83 Civ. 1745 (RLC) (S.D.N.Y.) and *Charles, et al v. Keaton, et al.*, Civil Action No. C-84-6320 (WHO) (N.D.

defendants to recover damages based on the same illegal trading in Santa Fe securities. The French respondents commenced two actions in the Southern District of New York and the Charles respondents instituted their action in the United States District Court for the Northern District of California.

In early February, 1986, the SEC entered into Consents and Undertakings with each of the defendants and the private litigants entered into a settlement agreement with the defendants. On February 26, 1986 the district court entered an "Order Establishing a Claims Fund and Claims Fund Procedure ("Order")." The Order set forth the terms of the settlement of the SEC enforcement action. Entry of the Order was also a condition precedent to settlement of the private lawsuits brought against the defendants.

Pursuant to the Order, within one day of its entry, $2.85 million of the monies which had been frozen by the Court were to be paid at the direction of defendants to the private litigating option traders, the Charles and French respondents.[2] In connection with

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Cal.). The French and Charles respondents did not merely allege violations of the federal securities laws but also alleged violation of RICO, 18 U.S.C. § 1961, *et seq.*, and common law causes of action, including fraud.

[2] Olagues' allegations that there was something improper about the settlement obtained by the Charles and French respondents is totally unfounded. As stated by the Court of Appeals: "[n]othing prevented . . . Olagues from bringing [his] own action against defendants, just as the French and Charles plaintiffs did." *SEC v. Cert. Unknown Purchasers of Commn Stock*, 817 F.2d 1018, 1022 (2d Cir. 1987). Indeed, as stated by the defendants in their Brief in Opposition to Olagues' Appeal to

the SEC settlement, the Order further provided for the creation of two separate funds; one to hold the defendants' disgorged profits derived from transactions in common stock from September 21, 1981 through September 23, 1981 (Claims Fund B, $492,317) and the other to hold disgorged profits from transactions and options during the period September 22 through October 1, 1981 (the "window period") (Claims Fund A, $4,499,527). Claims Fund A was further divided into two sub-funds. Sub-fund I represented claims of those who sustained losses in direct options trade with defendants during the window period. Sub-fund II represented the claims of those who did not deal directly but traded contemporaneously with the defendants and sustained losses as a result of options dealing during the window period. Only claimants who suffered actual out-of-pocket losses as a result of defendants' illegal trading were permitted, pursuant to the SEC settlement, to receive their pro rata share of the settlement proceeds.

On June 13, 1986, the district court held a hearing "to consider any objections of any claimant to the

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the Second Circuit:

> Fourth, the payment [to the Charles and French Respondents] was in part a recognition that, but for the private options traders (a) filing and pursuing their actions against the purchasers, (b) providing proof of their trades and actual losses, and (c) assisting in negotiating the settlement and drafting the settlement documents, the purchasers may never have agreed to settle the SEC action.

Defs. Br. at 9. As the Court of Appeals concluded, "[Olagues] should not expect to be able to stand aside and watch others incur the expenses of lengthy litigation and then expect the results of these efforts." *SEC v. Cert. Unknown Purchasers of Common Stock*, 817 F.2d at 1022.

claims procedure proposed by [the plan of settlement]." Joint Appendix at 127-28. Only three objectors, including petitioner Olagues, appeared at that hearing and urged Judge Connor to reject the Plan of Distribution. Olagues argued that the Plan's definition of the window period for which claims could be filed unfairly excluded him from participation in the settlement. In particular, Olagues claimed he was harmed by defendants' non-disclosure of inside information because he held option contracts that remained "open" during the window period when insider trading adversely affected the market. Judge Connor rejected Olagues' claim and denied his motion to intervene as a party under Fed. R. Civ. P. 24(a).

Olagues appealed the district court's decision which the Court of Appeals for the Second Circuit denied, affirming the lower court's denial of Olagues' motion to intervene and dismissing his appeal for lack of standing. The Court of Appeals held that generally only a party to an action has standing to appeal. Moreover, the Court found that Olagues could show no interest relating to the property or transaction which was the subject of the action since disgorgement of profits under the settlement agreement was based solely on the defendants potential Rule 10b-5 liability for insider trading during the window period. Insofar as Olagues had completed his transactions prior to that period he could not claim to have any significantly protectable interest in the litigation that would be impaired by the disposition of the case. The Court of Appeals found that the district court did not err in denying Olagues' motion to intervene because Olagues was not a party to the action and he lacked standing to challenge the settlement Order on appeal.

II. The District Court and Court of Appeals Correctly Disposed of Petitioner's Claims.

Olagues files this Petition for a *Writ* of *Certiorari* based on a claimed deprivation of procedural due process. Olagues argues that if he had been given notice to participate in the hearing on the Order approving the Plan of Distribution in which he alleges the trading window period was established, he would have had standing, and that the failure of the parties to accord him notice of this hearing accordingly constituted a deprivation of due process. Olagues' argument is erroneously predicated upon the belief that the Order providing for the Plan of Distribution as opposed to the SEC's Amended Complaint established the "trading window period". In any event, as held by the Court of Appeals for the Second Circuit in affirming the District Court's decision, Olagues has no claim to the settlement fund and no significantly protectable interest in the litigation that was impaired by the disposition of this case or the failure to give Olagues notice.

Although, Olagues now frames his appeal to this Court in terms of a failure to be granted notice, his real claim is the same as that raised before the District Court and Court of Appeals. Basically, Olagues argues that the claims period should have been broadened to include trades he conducted in August 1981, one and a half months before the defendants' transactions even took place. As the District Court and the Court of Appeals correctly noted in response to Olagues' objection, the proceeds of the disgorgement flow only from defendants trading during the period September 22 through October 1, since it was only during this period that the SEC's amended complaint

alleged that the options market was distorted by defendants' alleged insider trading.

Olagues argues that the SEC possessed information showing that defendant Nassir's illegal activity may have commenced as early as August 11, 1981 and that profits disgorged accordingly should have covered all those injured as a result of that activity. The question of the propriety of the SEC's decision not to seek to further amend its complaint to broaden the period of the alleged violation is not now nor would it have been at issue at the time of the hearing in connection with entry of the Order of the Plan of Distribution by the Court. Indeed while courts enjoy broad discretion in creating restitutionary remedies, they have generally held that in the context of government enforcement Consent decrees, "[u]nless a consent decree is unfair, inadequate or unreasonable, it ought to be approved." *SEC v. Randolph,* 736 F.2d 525, 529 (9th Cir. 1984). In *Randolph,* a related Santa Fe insider trading enforcement case, the Court of Appeals for the Ninth Circuit reversed the district court's disapproval of a Consent Decree because defendants were not required to pay prejudgment interest on disgorged profits. In so doing the court explained:

> The court should . . . defer [ ] to the agencies' decision that the decree is appropriate and simply insured [ ] that the proposed judgment is reasonable.

Id. Accordingly, district courts should pay deference to the judgment of the government agency which in its prosecutorial discretion decided to bring an action for a stated period of violation and which negotiates

and submits the proposed judgment based on that complaint. *Id.* at 529. *Accord, Marshall v. Holiday Magic, Inc.,* 550 F.2d 1173 (9th Cir. 1977); *U.S. v. City of Miami,* 614 F.2d 1322, 1332, n.18 (5th Cir. 1980), *aff'd as modified,* 664 F.2d 435 (5th Cir. 1981) (*en banc*) (presence of Justice Dept. in suit allowed court "safely [to] assume that the interest of all effected had been considered . . ."; *In re Mid-Atlantic Toyota Antitrust Litigation,* 564 F. Supp. 1379 (D. Md. 1983).[3]

Olagues cannot claim to be harmed by the Commission's decision not to broaden the allegations brought or the settlement obtained, since Olagues has a private right of action to sue for damages on whatever basis he might choose. Indeed, the Court of

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[3] Olagues' extensive citation of class action authority in support of his claimed deprivation of due process is inapposite. Olagues leaves the erroneous impression that the standards to be applied by the district court in reviewing the SEC's settlement should have been or were the same as those involving review of settlements in class action cases. This is not the case. Moreover, that a due process interest has been found to arise in the context of such class cases requiring notice of pendency and settlement is predicated on the binding nature of such judicial dispositions on individual members within the class. 2 *Newberg on Class Actions,* Section 8.04 (2d ed. 1986). Neither the private settlement nor the SEC disgorgement claims procedure finds those who either cannot or chose not to take advantage of the SEC disgorgement fund. All such individuals who may have been injured by the defendants' unlawful activities have their own private rights of action against the defendants. Moreover, neither the SEC nor the private French litigants have been or sought to be approved to or otherwise represent any class of injured investors. The SEC represents the public at large; the private litigants represented their own interests in securing damages sustained by them alone.

Appeals for the Second Circuit has held that injured investors may not intervene as of right in SEC enforcement proceedings precisely because of their private rights of action under the securities laws. As a result of such rights of action, individual injured investors cannot be said, for purposes of Fed. R. Civ. P. 24 to be so "so situated that the disposition of the [SEC enforcement] action will, as a practical matter, impair or impede their ability to protect their interest" as to the same violation. *SEC v. Everest Management Corp.*, 475 F.2d 1236, 1239 (2nd Cir. 1972). *See also, SEC v. Canadian Javelin, Ltd.*, 64 F.R.D. 648, 650-51 (S.D.N.Y. 1974), *appeal dismissed*, 538 F.2d 313 (2d Cir. 1976); *SEC v. Vesco*, 58 F.R.D. 182 (S.D.N.Y. 1973). Quite simply, third party injured investors have no vested interest in the remedy in an SEC disgorgement action since the disposition of such an action does not impair their private right to damages.

Moreover, the disgorgement remedy under the securities laws is a government enforcement mechanism the central purpose of which is to determine the amount by which a wrongdoer has been unjustly enriched and to make him disgorge that amount. *SEC v. Commonwealth Chemicals Securities, Inc.*, 573 F.2d 90, 102 (2d Cir. 1978); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978); *SEC v. Penn Central Co.*, 425 F. Supp. 593, 599 (E.D. Pa. 1976). The disgorgement remedy was not designed to provide redress victims who have suffered injury. If compensation results, it is only a by-product of the agency's efforts to reestablish compliance with its regulatory scheme. As stated by the Court of Appeals for the Sixth Circuit:

> Once the Commission has established that defendant has violated the securities laws, the district court possesses the equitable power to grant disgorgement without requiring whether, or to what extent, identifiable private parties have been damaged by [the defendant's] fraud.

SEC v. Blavin, 7660 F.2d 706, 713 (6th Cir. 1985). As otherwise stated by the court in *SEC v. Andes,* No. 82-1659, *slip op.* at p. 4 (E.D. Pa. Jan. 23, 1986) "it is significant to note that the primary purpose of disgorgement is not to compensate investors .... [T]his court does not view Mr. Hogan as having an 'entitlement' to share in the distribution here."

In sum, both the district court and the court of appeals have properly decided this case, the SEC reasonably entered into a settlement which based on the allegations of its complaint allowed claimants who, during an alleged period of violation, suffered out-of-pocket losses to receive a proportionate share of disgorged profits obtained in connection with an SEC enforcement matter. Mr. Olagues' transactions were completed before the commencement of the window period and he did not trade during the window period. The SEC properly exercised it prosecutorial discretion bringing the case in the manner in which it did and settling it in the manner which it did. Mr. Olagues has no interest which would have allowed him to intervene in the SEC proceeding since he cannot demonstrate any interest relating to the property or transaction which is the subject of the action. Because he was not induced by defendants acting on inside information to purchase or sell securities during the window period he has no claim under Rule 10b-5 to

the settlement fund and no significantly protectable interest in the litigation that could have been impaired. Indeed, he has no protectable interest in disgorgement funds whatsoever, since the disposition of any such funds whether they related to the same period or not did not impair Mr. Olagues' private right of action for damages. Both the District Court and the Court of Appeals were correct in their determination that Mr. Olagues lacked standing to challenge the settlement or to intervene in the litigation.

III. The Petition Fails to State a Reason For Granting Certiorari

Rule 17 of this Court provides:

> 1. A review on *writ* of *certiorari* is not a matter of right, but of judicial discretion, and will be granted only when there are special and important reasons therefore. The following, while neither controlling nor fully measuring the Court's discretion, indicate the character of reasons which will be considered:
>
> a. When a federal court of appeals has rendered a decision in conflict with a decision of another federal court of appeals on the same manner; or has decided a federal question in a way in conflict with a state court of last resort; or has so far departed from the accepted unusual course of judicial proceedings, or so far sanctioned such a departure by a lower court, as to call for an exercise of this court's power of supervision . . . .
>
> c. When a state court or a federal court of appeals has decided an important question of

> federal law which has not been, but should be, settled by this Court or has decided a federal question in a way in conflict with applicable decisions of this Court.

Olagues has shown no conflicts among the circuits, no conflict with the decisions of this Court, no important question of federal law that this Court has not previously decided, and certainly no unusual departure from the normal course of judicial proceedings.

IV. Conclusion

No basis for review by this court exists, the court below properly decided the matters raised before them, and no *writ* of *certiorari* should issue.

Respectfully submitted,
HERBERT E. MILSTEIN
Herbert E. Milstein
Steven J. Toll
Patricia F. Bak
COHEN, MILSTEIN & HAUSFELD
1401 New York Ave., N.W.
Suite 600
Washington, D.C. 20005
(202) 628-3500

Counsel for the French Respondents

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